

Finance Overview Part 2

Setting Rate Path Technical Assumptions

Presentation to the Customer Review Panel
November 9, 2016



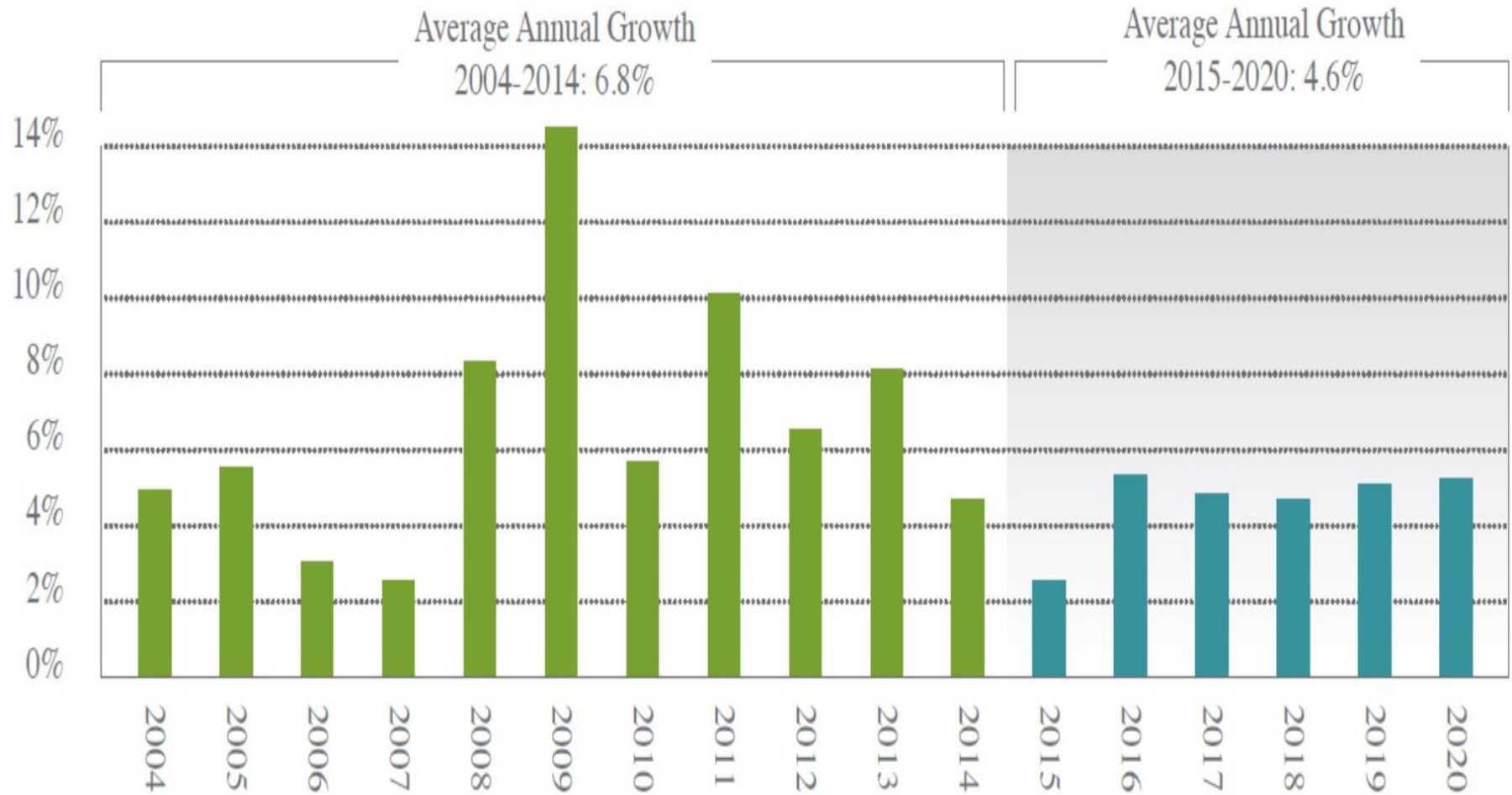
What is the Purpose of this Presentation?

Provides an opportunity to increase understanding of SPU's rate setting process, specifically around:

- Rates and forecasting
- Technical assumptions in the rates

But first, a brief summary of what we discussed last time

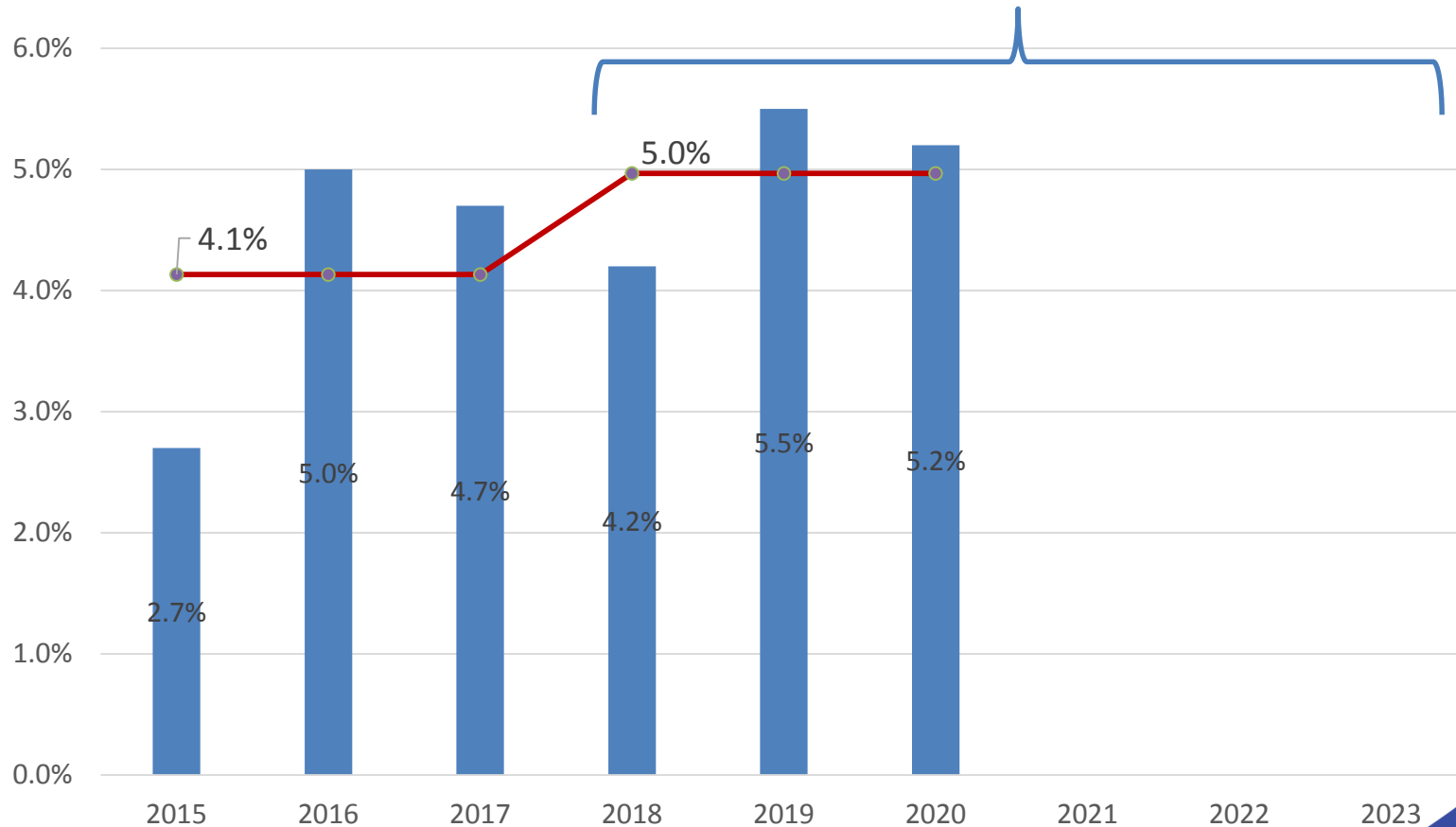
From last time: rates growing at slower pace



The Plan is projected to create more predictable, lower rate increases than during the previous 10-year period.

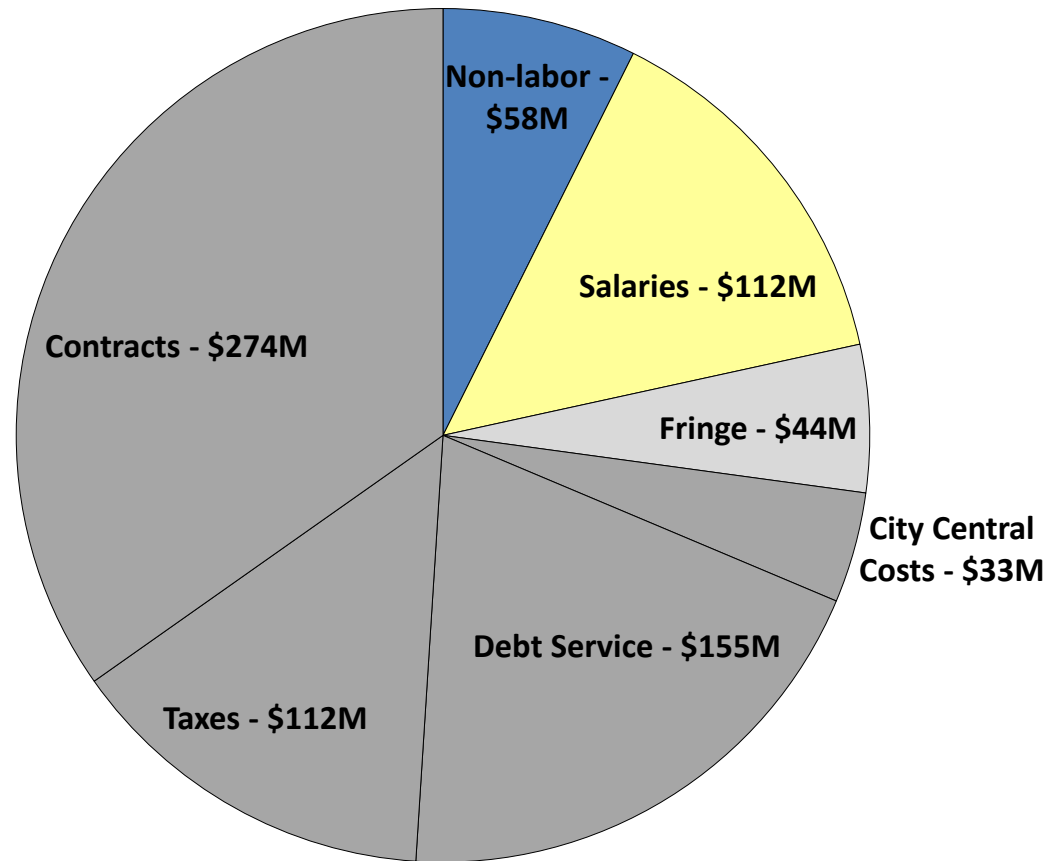
From last time: Strategic Business Plan Rate Path of 4.6% is Back-loaded

Strategic Business Plan Update: 6-year rate path TBD



From last time: Many operating & maintenance costs are non-discretionary

2016 O&M Spending Plan: \$788M



From last time: lots of financial policies

NET INCOME



DEBT SERVICE COVERAGE



CIP - CASH VS. DEBT FINANCING



YEAR-END CASH BALANCE



From last time: strong financial policies lead to high bond ratings

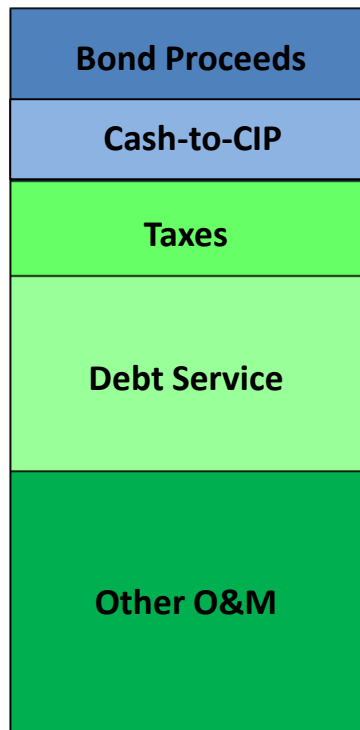
	Standard &Poors	Moody's
Prime Maximum Safety	AAA	Aaa
High Grade High Quality	AA+ Water, DWF	Aa1 Water, DWF
	AA Solid Waste	Aa2
	AA-	Aa3 Solid Waste
Upper Medium Grade	A+ A A-	A1 A2 A3
Lower Medium Grade	BBB+ BBB BBB-	Baa1 Baa2 Baa3
Non Investment Grade	BB+	Ba1

Forecasts and the Rates Process : Starting with Spending

(example from 2016 water rate study)

**“How much
will we
spend?”**

\$314M

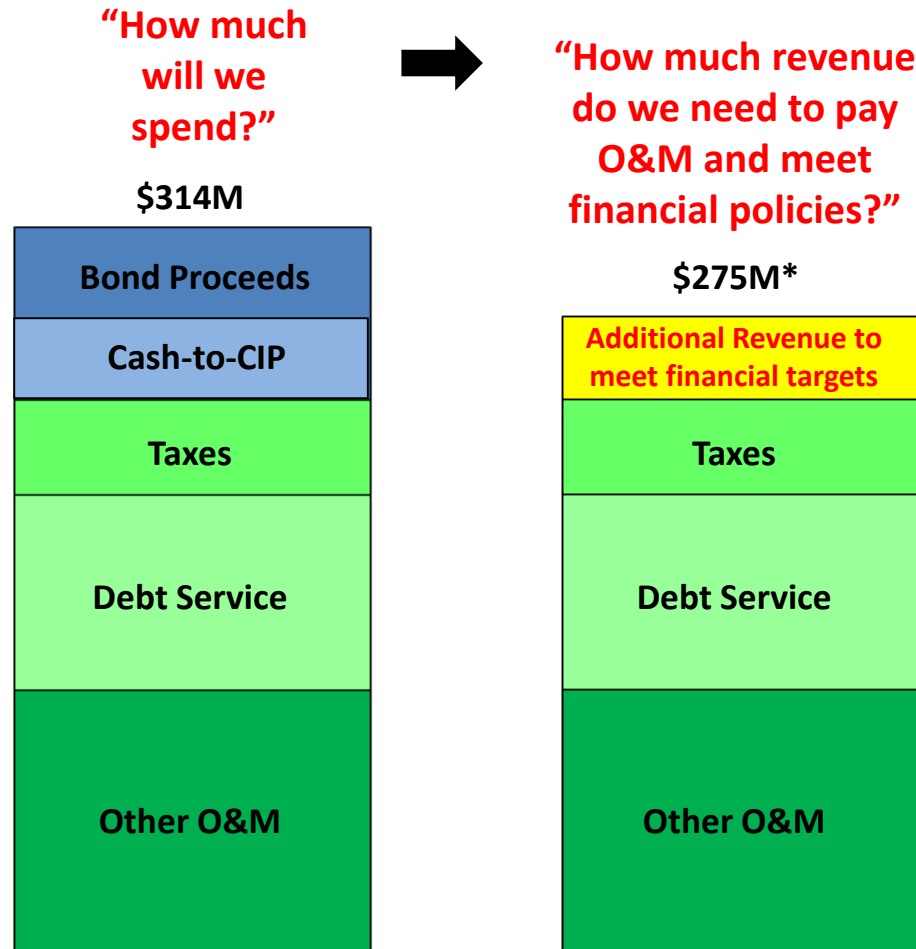


* Required revenue lower than total budget due to use of bond proceeds

Forecasts and the Rates Process:

Costs Covered with Current Revenues and Cash

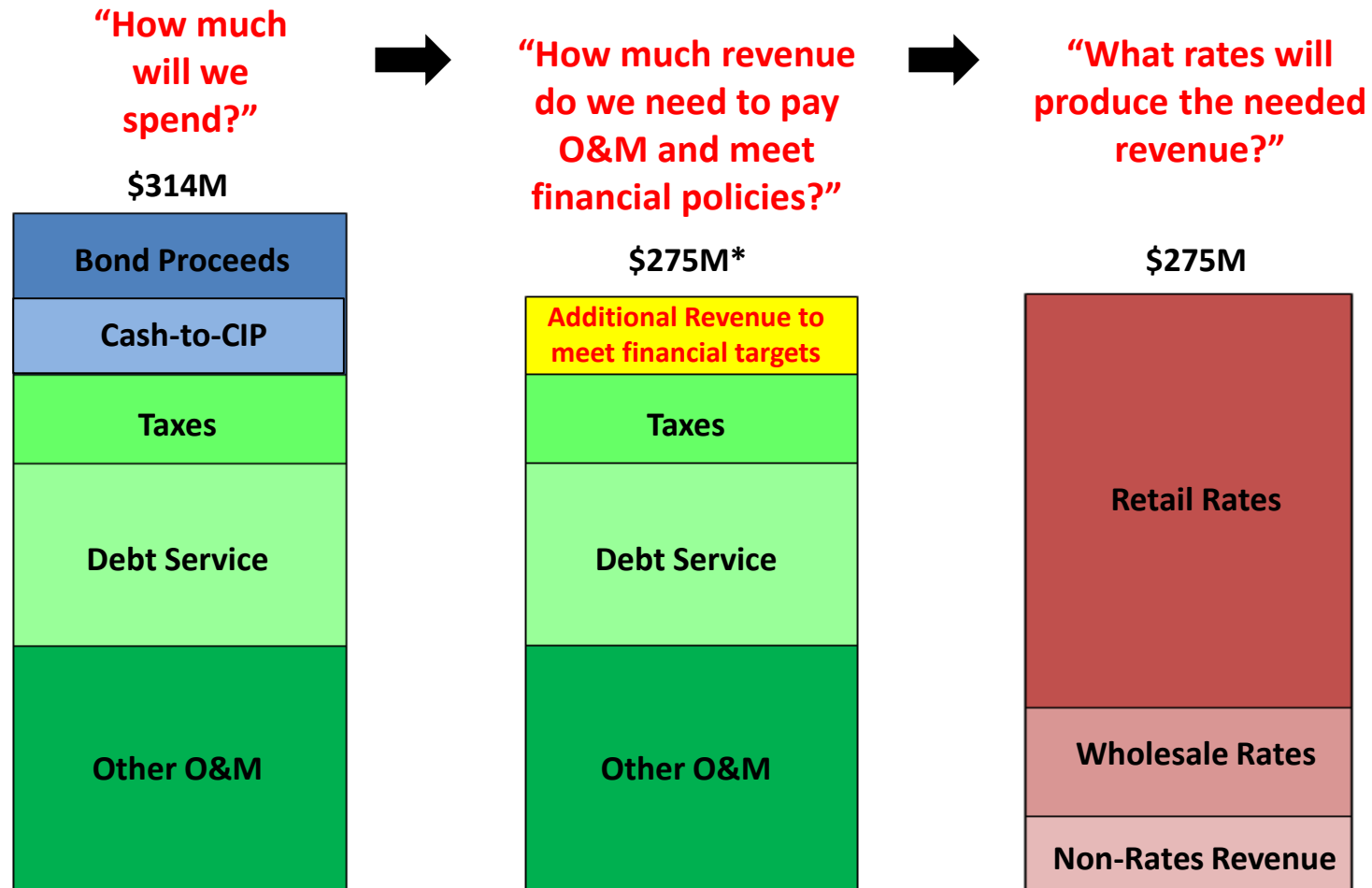
(example from 2016 water rate study)



* Required revenue lower than total budget due to use of bond proceeds

Forecasts and the Rates Process: Setting Rate Levels

(example from 2016 water rate study)



* Required revenue lower than total budget due to use of bond proceeds

Forecasts and the Strategic Business Plan

- The Strategic Business Plan is like three rate studies rolled into one
- The Strategic Business Plan projects costs and services over six years instead of the three years projected during the individual rate studies
- The Strategic Business Plan projects average rates for all customer classes, not rates by each customer class
- The further out we go, the more uncertainty and financial risk there is

Technical assumptions in 2018-2023 baseline rates

1. Definition of baseline rates, and why we calculate a baseline
2. Inflation assumptions
3. Demand
4. Other

Baseline Rates

- Definition: *Baseline rates are the rates necessary in 2018-2023 to maintain current service levels and meet firm regulatory requirements*
- Why we calculate a baseline: The baseline is our starting point for rate discussions. We will review with you the technical assumptions and policy decisions embedded in the baseline.
- What are the next steps in rate setting: The next steps are reviewing potential savings and Action Plan investments.

Technical assumptions in 2018-2023 baseline rates:

Inflation assumptions are similar to 2015-2020

Topic	Assumptions in 2015-2020 SBP	Assumptions in 2018-2023 draft rate path
Health care inflation	7%/year	6.4% in 2018; 6.0% thereafter
Workers comp inflation	3%/year	3%/year
Salary inflation	1.6% in 2015; 2.2% in 2016; 2.5% thereafter	2.75% in 2018; 2.4% thereafter
Retirement costs	City contribution of 15.3% in 2015-16; 16.3% in 2017-2020	15.5% in 2018; 16.0% thereafter
Professional services inflation	3%/year	3%/year
Charges from other City departments: <ul style="list-style-type: none"> General allocations Finance & Administrative Services Seattle IT allocation Seattle IT billed Fleets – allocation Fleets - fuel Fleets – maintenance 	Year 1/Year 2 of biennium: <ul style="list-style-type: none"> 8%/4% 8%/5% 12%/5% 12%/7% 11%/7% 11%/7% 11%/4% 	Year 1/Year 2 of biennium: <ul style="list-style-type: none"> 6%/6% 6%/6% 6%/6% 6%/6% 11%/7% 11%/7% 11%/4%
Other O&M inflation	2% per year	Generally 2%/year

Technical assumptions in 2018-2023 baseline rates: Inflation assumptions on large contracts

Drainage and Wastewater large contract is King County's rate for sewer treatment; inflation assumption based on County projections. 2017 costs total \$161.7 million.

Solid Waste large contracts are the collection, hauling, and disposal contracts for garbage, recycling, and organics. Actual payments depend on a consumer price index, a labor cost index, and fuel costs. 2017 costs total \$111.0 million.

Fund	Large Contracts Inflation						
	2017	2018	2019	2020	2021	2022	2023
Drainage and Wastewater	5.2%	0.0%	6.4%	0.0%	3.0%	3.0%	3.0%
Solid Waste	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%

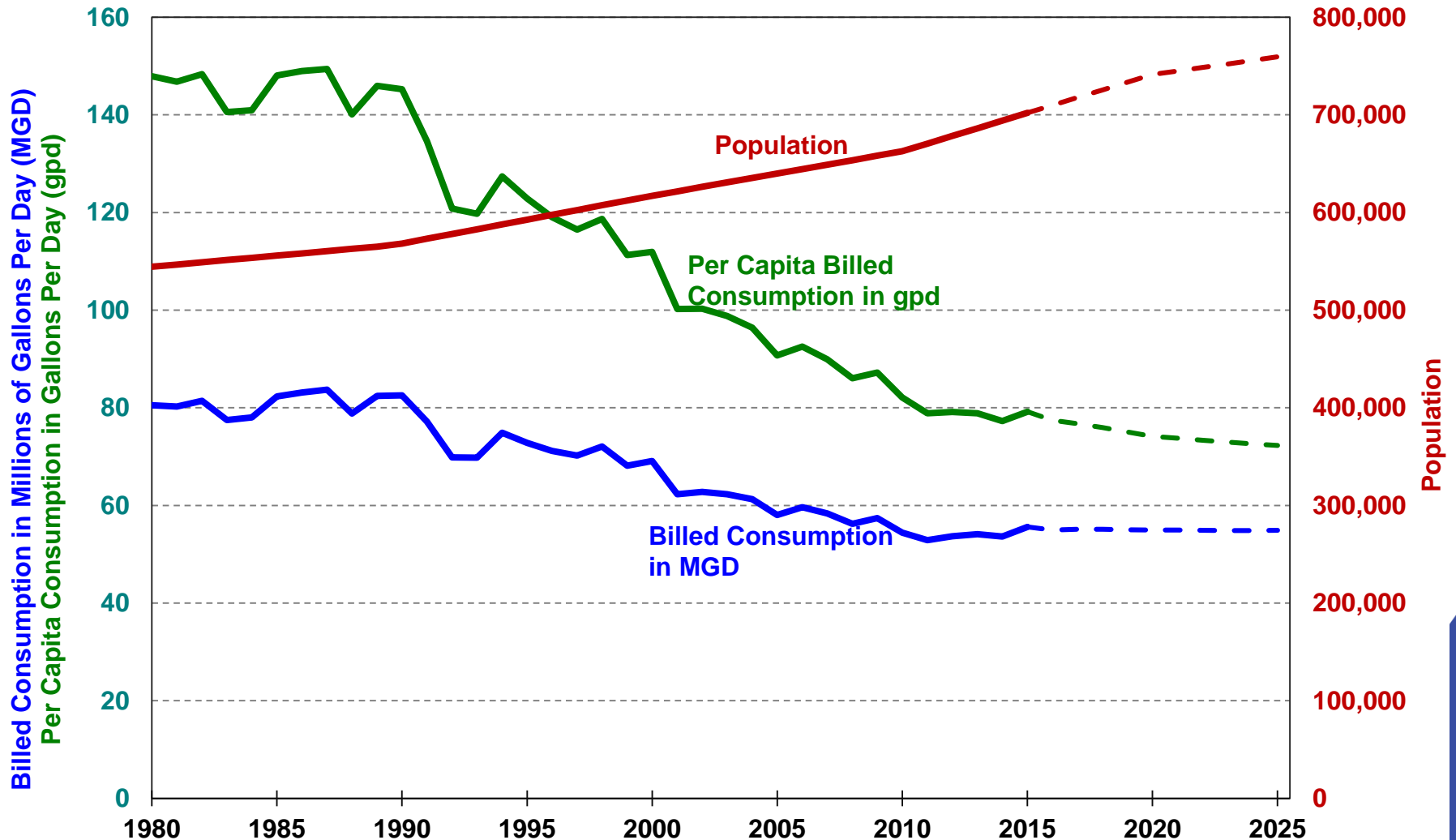
Technical assumptions in 2018-2023 baseline rates:

Demand relatively constant

- Water and wastewater reset slightly higher in 2018; decline minimally thereafter
- Drainage demand constant
- Solid Waste increasing tons as population increases
 - Organics and recycling increases are leading to declining garbage can sizes

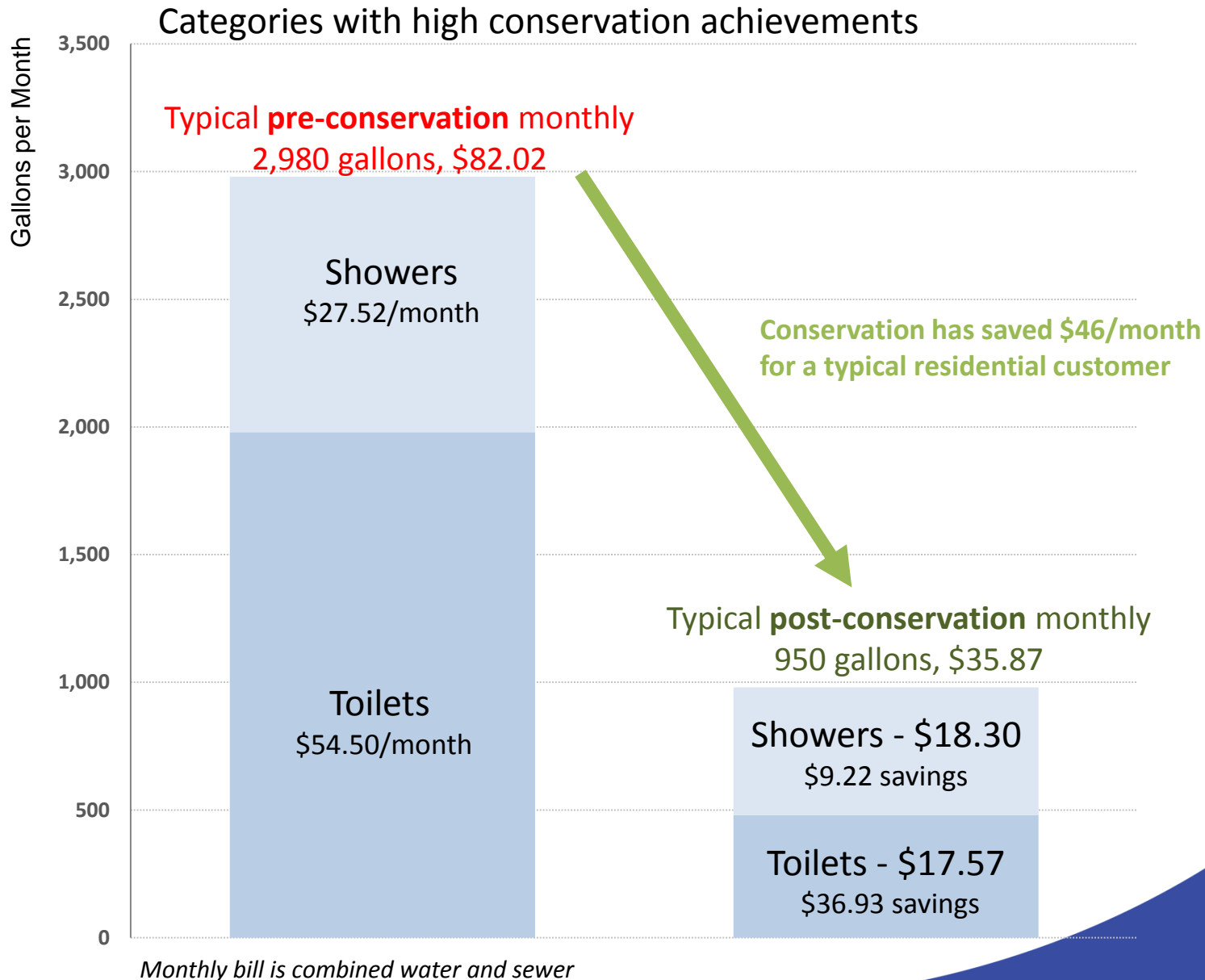
Consumption and Population

Actual and Forecast* Growth in Seattle Retail Water Consumption and Population: 1980-2025



* Forecasts are Preliminary Draft

The Impacts of Conservation



Technical assumptions in 2018-2023 baseline rates:

Other

- Bond interest rates set per advice of City's financial advisor
 - In Water Fund, assume 4.75% interest rate in 2017 and 5.0% thereafter
 - In Drainage and Wastewater Fund, assume 5.0% interest rate through 2023
- Assume 100% accomplishment rate for capital program

What to remember

1. 6-year rate path in SBP is divided into two 3-year chunks, with greater uncertainty and financial risk in the final 3 years
2. Lots of technical assumptions impacting rates and financial risk
3. Customer Panel will be asked to offer their comments on all of this in the new year

QUESTIONS?

